

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Date: January 11, 2013

LEGEND:

Taxpayer =

State X =

Date 1 =

Dear :

This responds to a letter dated August 27, 2012, submitted on behalf of Taxpayer requesting a private letter ruling that certain mortgage loans and mezzanine loans held by Taxpayer will not be treated as “securities” for purposes of the 25 percent taxable REIT subsidiary (“TRS”) value test set forth in section 856(c)(4)(B)(ii) of the Internal Revenue Code.

FACTS

Taxpayer is a State X corporation that has elected to be treated as a real estate investment trust (“REIT”) for federal tax purposes beginning with the taxable year ended Date 1. For federal tax purposes Taxpayer uses an accrual method of accounting and files its federal tax returns on a calendar year basis.

Taxpayer is a publicly traded commercial real estate finance and investment company. Taxpayer’s primary business activities are real estate lending, net leasing, and real estate investing. Taxpayer holds certain of its assets through: (1) wholly

owned corporations treated as qualified REIT subsidiaries (“QRSs”), (2) wholly owned limited liability companies (“LLCs”) (that are treated as disregarded entities for federal income tax purposes) (“DRE Subsidiaries”), and (3) interests in partnerships and LLCs that are treated as partnerships for federal income tax purposes (“Partnership Subsidiaries”). Taxpayer owns 100 percent of the outstanding equity (either directly or indirectly through QRS and DRE Subsidiaries) of several subsidiaries that Taxpayer treats as TRSs within the meaning of section 856(l). Taxpayer also owns less than 100 percent of the indirect interests in certain other TRSs that it holds through Partnership Subsidiaries.

Taxpayer’s TRSs finance their asset acquisitions and operations in part through mortgage loans (“Mortgage Loans”) from Taxpayer that are secured by the real property owned by the TRSs, and in part through mezzanine loans (“Mezzanine Loans”) from Taxpayer that are secured by the equity of a partnership, or an LLC treated either as a partnership or as a disregarded entity. A number of such loans are held indirectly by Taxpayer through QRS and DRE Subsidiaries.

LAW AND ANALYSIS

Section 856(c)(4)(A) provides that at the close of each quarter of the taxable year at least 75 percent of the value of a REIT’s total assets must be represented by real estate assets, cash and cash items (including receivables), and Government securities.

Section 856(c)(4)(B) provides, in relevant part, that at the close of each quarter of a taxable year, (i) not more than 25 percent of the value of a REIT’s total assets may be represented by securities (other than those includible under section 856(c)(4)(A)); (ii) not more than 25 percent of the value of the REIT’s total assets may be represented by securities of TRSs (the “25% Value Test”); (iii) not more than 5 percent of the value of the REIT’s total assets may be represented by securities of any one issuer (except with respect to a TRS and securities includible under section 856(c)(4)(A)); and (iv) a REIT may not hold securities possessing more than 10 percent of the total voting power or value of the outstanding securities of a single issuer (except with respect to a TRS and securities includible under section 856(c)(4)(A)).

Section 856(c)(5)(B) defines the term “real estate assets” to mean, in part, real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other REITs. Section 1.856-3(e) of the Income Tax Regulations provides that the term “securities” does not include “real estate assets” as defined in sections 856 and 1.856-3.

Revenue Procedure 2003-65, 2003-2 C.B. 336, sets forth a safe harbor under which a mezzanine loan made by a REIT that is secured either by a partnership interest

in a partnership or by the sole membership interest in a disregarded entity, will be treated as a real estate asset for purposes of sections 856(c)(4)(A) and 856(c)(5)(B). Furthermore, Revenue Procedure 2003-65 provides that the interest on the loan will be treated as interest on an obligation secured by a mortgage on real property or on an interest in real property for purposes of section 856(c)(3). Taxpayer has represented that all of the Mezzanine Loans satisfy the safe harbor requirements set forth in Revenue Procedure 2003-65, and thus qualify to be treated as “real estate assets” for purposes of sections 856(c)(4) and 856(c)(5)(B).

Under section 856(c)(4)(B)(ii), a REIT is permitted to hold the securities of one or more TRSs as long as such securities do not exceed 25 percent of the value of the REIT's total assets. The specific issues presented in this ruling request are whether, for purposes of the 25% Value Test under section 856(c)(4)(B)(ii), the term “securities” includes a loan to a TRS that qualifies as a real estate asset under section 856(c)(5)(B), and whether the term “securities” includes a mezzanine loan that qualifies for the safe harbor set forth in Revenue Procedure 2003-65.

The 25% Value Test under section 856(c)(4)(B)(ii) insures that only a limited portion of REIT assets can be invested in assets other than real estate or other assets included in section 856(c)(4)(A). As a result, the term “securities” in this context does not include real estate assets as defined in sections 856 and 1.856-3.

Section 856(c)(5)(B) provides the rule that loans secured by real property are real estate assets. Revenue Procedure 2003-65 provides the rule that mezzanine loans that qualify for the safe harbor set forth in Revenue Procedure 2003-65 are also treated as real estate assets. These rules, however, are only applicable to loans that are held directly or indirectly by a REIT. In the present case, Taxpayer has represented that all of the Mortgage Loans are held directly or indirectly by Taxpayer. Furthermore, Taxpayer has represented that all of the Mezzanine Loans are held directly or indirectly by Taxpayer.

CONCLUSION

Accordingly, based on the information submitted and representations made, we conclude that Mortgage Loans from Taxpayer to its TRSs that are secured by real property and qualify as real estate assets within the meaning of section 856(c)(5)(B) will not be treated as securities for purposes of the 25% Value Test under section 856(c)(4)(B)(ii). Furthermore, we conclude that the Mezzanine Loans that qualify for the safe harbor set forth in Revenue Procedure 2003-65 will not be treated as securities for purposes of the 25% Value Test under section 856(c)(4)(B)(ii).

This ruling's application is limited to the facts, representations, Code sections, and Regulations cited herein. No opinion is expressed with regard to whether Taxpayer otherwise qualifies as a REIT under subchapter M of the Code. No opinion is expressed as to whether Taxpayer's Mezzanine Loans meet the requirements of Revenue Procedure 2003-65 and therefore qualify as real estate assets under sections 856(c)(4) and 856(c)(5)(B). In addition, no opinion is expressed as to whether Taxpayer's Mortgage Loans qualify as real estate assets under sections 856(c)(4) and 856(c)(5)(B).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

K. Scott Brown
Branch Chief, Branch 3
Office of Associate Chief Counsel
(Financial Institutions & Products)

Enclosures:

Copy of this letter

Copy for section 6110 purposes